

COELUM

Monthly Digital Publication by
ABOGADOS SIERRA Y VAZQUEZ

June 15, 2015 year 10 | No. 02

Discharge of Mortgages and
its Incidence in respect to
Engine SWAP.

by Viridiana Barquín
P. 01-03

MAY NEWS on
Mexican Aviation
P. 04-05

Contributors
P. 06

ABOGADOS
SIERRA Y
VAZQUEZ

COELUM

Pronunciation: 'che-l&m, is Latin for airspace or sky. The Romans began questioning the rights they had in the space above the land they owned and to how high above did that right extended to. Ad coelum et ad inferos, they discussed, meaning that their right of property would extend as high up to the heavens and down to hell.

Discharge of Mortgages and its Incidence in respect to Engine SWAP.

by Viridiana Barquín

When analyzing the right that a Lessee may have to conduct an engine swap under an aircraft lease agreement and the mechanisms to protect the rights and interests of each party that holds title in respect to the corresponding assets that involves the aircraft after such engine swap, we need to consider what happens with an engine installed in an aircraft subject to a mortgage, pledge or a lien. A common concern is that the engine could be considered as part of the mortgaged property and furthermore, a major concern is that the owner of the engine could lose the property rights thereon and that the engine could be considered owned by the owner of the aircraft.

Pursuant to Article 2, of the Civil Aviation Law ¹; *“aircraft is any vehicle capable to flight autonomously in the aerospace to transport passengers, cargo or mail”*. Pursuant to the Civil Aviation Organization, *“an aircraft is any machine that can derive support in the atmosphere from the reactions of the air other than the reactions of the air against the earth’s surface”*.²

Therefore, we note that the Civil Aviation Law by definition, does not include specifically the engines as part of the aircraft, so it is an insufficient definition since no reference is made to the property rights of the parties concerning to each of the assets comprising the unit; however, if evidence of ownership rights by the owner of the engine is provided, it would not be considered as part of the mortgaged property nor as owned by the owner of the aircraft, but it is important to take into account certain elements and practical problems when dealing with the discharge of a mortgage over an aircraft where an engine different from the one originally installed has been discharged and released. A discharge will normally occur when (i) the aircraft has been sold, or (ii) the mortgage has been paid out and the mortgage is legally terminated.

In either case, there are different parties with property rights to be recognized: the new owner of the aircraft in case (i) above, the party being released from the obligations under the mortgage in case (ii), and in both cases, the owner of the engine(s) that had been swapped.

The Civil Aviation Law, has no specific regulation related to mortgages, pledges or liens over an aircraft or its parts, and unfortunately when the Civil Aviation Law entered into effect it repealed and omitted many provisions that the Law of General Communications (*“Ley de Vías Generales de Comunicación”*, *“LVGC”* by its acronym in Spanish)³ actually contained in respect to mortgage of aircraft and the pledge of engines and spare parts⁴. However, the Civil Aviation Law provides that any and all documents by which the ownership possession are acquired, prevented, extinguished, modified, encumbered, or any

1.- Published on May 12, 1995 in the Official Journal of the Federation (*“Diario Oficial de la Federación”*, *“DOF”* by its acronym in Spanish), last modification published on January 26, 2015.

2.- ICAO Annex 1, Annex 6 Part I, Definitions and General Regulations relating to Licensing, 1.1 Definition (July 2006, tenth edition).

3.- Published on February 19, 1940 in the DOF, last modification published on July 14, 2014.

4.- This LVGC (repealed by the Civil Aviation Law in effect), clearly and specifically distinguished under Article 362, that the aircraft would be subject to mortgage and, on the other hand, the engines and parts would be subject to pledge. In addition, Article 364 specified the requirements that must be contained in the mortgage and/or pledge agreements in order to identify the mortgaged and/or pledged property, therefore, in addition to the requirements under the applicable law, a description of the mortgaged aircraft and/or pledged equipment, registration marks, specification of model and manufacture, the manufacturer serial number and all the information necessary to undoubtedly identify the aircraft or the engine.

other rights in-rem over Mexican civil aircraft, must be registered⁵ at the Mexican Aviation Registry (“RAM”). Although, it has been explained above that Mexican law does not consider that if an engine is swapped and installed in an aircraft, such engine would be part of the same as if it were a sole and single asset, it is important to note that, the physical repossession of the engine installed due to an engine swap would only be possible if it is redelivered by the counterparty willingly or through a prior judicial order.

In that sense, and analysing the event that a judicial order would be required, it is understood that the lessee was the party with the obligation to reinstall both of the engines originally received with the aircraft, and therefore is the first liable before the owner of the engine swapped, and secondly the counterparty that would not accept to redeliver the engine willingly (for instance, the new owner that it is acquiring the aircraft without knowledge that one of the engines was swapped and is owned by another company). The procedure to obtain this judicial order involves then the filing of suit against the lessee by the owner of the engine swapped, claiming the rescission of the relevant engine lease agreement, and demonstrating the default incurred by the lessee thereunder and to provide evidence of the property rights of the owner of such engine to be recognized and enforced⁶.

“And what happens if there is an engine that was originally installed in an aircraft over which a mortgage has been already released but it is now installed on a different aircraft with a mortgage in full force and effect and that has not been canceled?”.

The above, without prejudice of the rights of enforcement of (a) the new owner of the aircraft that it is acquiring the same without knowledge of the property rights of the owner of the engine swapped; and/or (b) the party being released of the obligations under the mortgage being cancelled and released due to the payment of the obligations that were secured by such mortgage. Considering that, the Civil Aviation Law does not include specific provisions (such as those that were included in the LVGC, but that were thereafter lapsed with the entry into force of the Civil Aviation Law), to differentiate the security interests applicable to the aircraft to those applicable to the engines and the relevant requirements for easy identification of each asset; we should go to the applicable law which in this case corresponds to Federal Civil Code⁷ which in accordance with Article 2893, the Mortgage

5.- Article 47, I.

6.- An aircraft or engine lease agreement is a commercial contract in nature and by such; it must be resolved in Mexico under the rules established by the Commercial Code “(Codigo de Comercio)”, Articles 1377 through 1390, which regulate the ordinary process (“Ordinary Commercial Procedure”) and its stages. On the other hand, there is a summary procedure (“Executive Commercial Procedure”) regulated under Articles 1391 through 1414, that is almost identical to the Ordinary Commercial Procedure and involves the same stages and requirements, although such are resolved within shorter statutory periods making it in fact a more expeditious process. The principal difference between these two proceedings is however that in the Executive Commercial Procedure the plaintiff is able to obtain the order for the securement of enough assets of the Lessee that would serve as guarantee of the amount of its claim from moment when the process initiates. This allows plaintiff to be certain that in the event it shall prevail in its claim against Lessee after all instances have been exhausted, there will be enough assets to guaranty that the indemnity obligations of Lessee as ordered by the resultant judgment will be able to be met in full, eliminating the risk that Lessee shall be found not to have enough assets to honor the payment obligations to which it shall be condemned after a long and tedious Ordinary Commercial Procedure.

7.- Published on August 31, 1928 in the DOF, last modification published on December 24, 2013.

is defined as a right 'in rem' conformed over an asset that it is not delivered to the Creditor, and conferring the right to such Creditor, to be paid with the value of the mortgaged property, in the event that the secured obligation, is in default, in the priority order established by law; and, in accordance with Article 2856, the Pledge is defined as a right 'in rem' conformed upon a transferable asset in order to guarantee the compliance of an obligation and its payment priority. In spite of this, the perfect identification of the assets subject to an aircraft mortgage, has some difficulties; situation that does not occur if the security interest to be created corresponds exclusively to an engine, in which case, would not be a mortgage but a pledge the lien that would have to be constituted.

“Under all these approaches, it is valid to bring the question of whether we should re-evaluate our practice and make a new assessment in respect to the most suitable kind of security interest that should be constituted in respect to an aircraft as a whole; or, in respect to an aircraft and the engines, respectively.”

And what happens for example, if contrario sensu, there is an engine that was originally installed in an aircraft over which a mortgage has been already released but it is now installed on a different aircraft with a mortgage in full force and effect and that has not been canceled?

Whereas, there will be clear to the competent authority that the aircraft is not a indivisible unit, and that the lessee will be obliged to restore the original engine if it was replaced from the aircraft on which originally installed, to another (with costs involved in respect thereto); it is also evident that in practice, all such determinations would not be that simple nor so expeditious in the event that a confusion exist due to an engine swap, as to the rights of any counterparty acquiring in good faith.

Under all these approaches, it is valid to bring the question of whether we should re-evaluate our practice and make a new assessment in respect to the most suitable kind of security interest that should be constituted in respect to an aircraft as a whole; or, in respect to an aircraft and the engines, respectively. Maybe it is time to consider that the enforcement of a pledge could be less complicated than the mortgage, or maybe, it is time to consider the option to separate the assets having two different contracts: a mortgage in respect to the aircraft (without the engines), and a pledge, in respect to the engines individually and separately from the aircraft.

First Mexican designed Aircraft.

The Mexican company Oaxaca Aerospace has presented the first prototype aircraft developed with Mexican technology. The aircraft Pegasus PE-210A can be distinguished by its wings which allow major mobility and the aircraft has a major last generation software with a modern aerodynamic design. The first Mexican designed aircraft is foreseen to start producing aircraft in 4 years. *informador.com.mx* May 07, 2015.

Bombardier strengthens its manufacture of aerospace components.

Bombardier announced that a new production line is being installed soon at its Queretaro plant. "Queretaro's facilities are strategic to Bombardier's commercial operation", said Alfredo Nolasco, Head of Operations for Bombardier Mexico, adding that the company expects to step up with this new production line, after last year's job cuts. Nolasco stated that Bombardier's restructuring process is now complete, as he affirmed that restoring the growth of Bombardier Mexico will help to keep up the growth of this industry nationwide, since Mexico is already the Latin American aerospace leader over Brazil. *mexico-now.com* May 14, 2015

Chihuahua seeks to land Boeing plant.

Boeing is currently studying the feasibility to have a new aerospace components factory set up in Chihuahua, where 1,000 people would be employed. Cesar Duarte, Chihuahua's Governor, met with the Company's executives to discuss the opportunities and advantages this state's aerospace cluster offers. According to Mr. Duarte, if negotiations result as expected, the new Boeing plant would be installed in Ciudad Juarez, to expand its portfolio of aircraft components made in this state. The Aerospace industry in Mexico recorded growth rates of 15% per year and Chihuahua is a leader in this sector with 25 companies operating across the State, which generate 11,000 jobs, with annual exports estimated at US\$750 million. *mexico-now.com* May 14, 2015

FAA Starts "No Drone Zone" Campaign.

The FAA just launched a new public campaign designed to inform people of areas in which drones are not allowed. The campaign's main purpose is for awareness of the fact that there is a 15-mile radius of Ronald-Reagan Washington National Airport which does not allow for drones to be airborne. As of now Washington, D.C. is the only place in the U.S. in which this program has been implemented due to the airspace being more restricted than in any other part of the country. *generalaviationnews.com*. May 14, 2015

Fitness Tests to be made by FAA.

Due to accidents in the recent months the FAA is looking to implement fitness studies, both mental and physical, in order to maintain a better aircraft security. Many commercial aviation and medical communities have started working with the FAA in order to produce recommendations as to what the physical and mental statuses of the pilots should be. It is estimated that these recommendations will be delivered to the FAA in approximately six months. *generalaviationnews.com. May 14, 2015*

Flying-Car Prototype Unveiled.

Carplane, a German company, has unveiled their first prototype for their flying car which is expected to undertake its first flight later this year. The flying-car features a twin hull in order to resemble with more authenticity the experience of flying a regular car. It also features a 151-hp piston engine which capacitates it to be able to be driven both in the air as well as in the ground. The car will also feature foldable wing for it to appear like a car while in the ground. It is being said that an Aircraft Pilot's license will be needed to be able to drive it. *aviationweek.com May 27, 2015.*

World's Largest Engine Enters Crucial Test Phase.

What is being called the world's largest engine, the GE9X, is set to go through crucial test in order for the first core to be completed by this summer. The engine is not set to be used in an aircraft until 2020 but despite this the manufacturers are moving in a really quick pace in order to complete the first core as soon as possible. The engine is to be featured in the largest twin engine aircraft and is tentatively set to enter operation in the year 2020. *aviationweek.com May 27, 2015.*

The Secretary of National Defense will invest around 800 million dollars in aviation assets.

The Mexican Secretary of National Defense (SEDENA) has made public the objective of modernizing their air fleet. The Federal branch has stated that it will acquire three state of art new aircraft. The plan to modernize the federal government's fleet comes as result of the imperative need to change the current aircraft which are now out dated for the strategic operations that the SEDENA performs. *informador.com.mx May 29, 2015.*

COELUM

Monthly Digital Publication by
ABOGADOS SIERRA Y VÁZQUEZ

CONTRIBUTORS

Viridiana Barquín

Attorney at Law: Admitted to practice law in 1999. Mrs. Barquín, of Mexican nationality obtained her law degree at Universidad La Salle, Mexico City and holds a Master Degree in International Business by Universidad La Salle, Barcelona, Spain; Airline Contract Law by International Air Transport Association (IATA), Geneva, Switzerland and International Arbitration by Escuela Libre de Derecho, Mexico City.

LANGUAGES: Spanish, English and Catalan.

PRACTICE AREAS: Aviation Law, Aircraft Contract Law and Corporate Law.

e-mail: vbarquin@asyv.com

ABOGADOS
SIERRA Y
VÁZQUEZ

Prol. Reforma No. 1190 25th Floor
Santa Fe México D.F. 05349
t. (52.55) 52.92.78.14
f. (52.55) 52.92.78.06
www.asyv.com / www.asyv.aero

The articles appearing on this and on all other issues of Coelum reflect the views and knowledge only of the individuals that have written the same and do not constitute or should be construed to contain legal advice given by such writers, by this firm or by any of its members or employees. The articles and contents of this newsletter are not intended to be relied upon as legal opinions. The editors of this newsletter and the partners and members of Abogados Sierra y Vazquez SC shall not be liable for any comments made, errors incurred, insufficiencies or inaccuracies related to any of the contents of this free newsletter, which should be regarded only as an informational courtesy to all recipients of the same.